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Investing According to your Social Conscience Doesn't Hinder Potential Returns, Says New Study

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Contact: Pam Huber, huber@udayton.edu

INVESTING ACCORDING TO YOUR SOCIAL CONSCIENCE DOESN'T HINDER POTENTIAL RETURNS, SAYS NEW STUDY

DAYTON, Ohio — People who invest with an eye toward social responsibility can make just as much money as those who don't restrict their investments, according to a study published this month.

"The general consensus has been that when you restrict your investment universe, you run the risk of affecting the level and predictability of your returns," said David Sauer, associate professor of economics and finance at the University of Dayton. "But the bottom line is that applying social responsibility screens does not necessarily result in inferior performance. You can do as well as those who invest in an unrestricted portfolio."

Sauer's study on socially responsible investing will be published in the forthcoming issue of the *Review of Financial Economics Research,* a biannual academic journal.

Socially responsible firms are, commonly, those not manufacturing alcohol or tobacco products, military weapons or nuclear power or involved in gambling. They are also defined as responsive to preserving the environment and concerned with product quality and the needs of consumers, employees, minorities, women, vendors and the community.

A growing number of investors are choosing to support companies that operate in ways that reflect their own value systems and beliefs, Sauer said.

In November, a Social Investment Forum study showed $1.185 trillion in U.S. socially screened investments, up 85 percent from $639 billion in 1995. The figure was $40 billion in 1984. The number of socially and environmentally responsible mutual funds has jumped 162 percent over the past two years, with 55 listed in 1995 and 144 listed in 1997, according to the study.

Proponents of socially responsible investing believe those companies can be more stable and less likely to encounter environmental or product liability lawsuits, Sauer said. "They tend to develop tremendous loyalty from their customers and employees, and that can result in increased sales, improved productivity and innovation, and lower production costs," he said.

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Office of Public Relations
300 College Park Dayton, Ohio 45469-1679 (937) 229-3241 Fax: (937) 229-3063
http://www.udayton.edu

There are arguments against the practice, he said.

"With screens, you can eliminate entire industries and the larger conglomerate firms, which would seem to reduce diversification," Sauer said, adding that firms that pass the screens will tend to be smaller and may likely have more volatile returns. "And then you have the additional screening and monitoring costs."

Sauer's findings show that investors can achieve reasonable diversification and the extra costs turn out to be negligible. None of the portfolios or funds in the study is actively managed, eliminating variables such as management fees, transaction costs and the differences in style and abilities of fund managers.

To examine returns, Sauer compared the performance of a well-diversified portfolio of socially screened stocks — the Domini 400 Social Index, established in 1990 — with two unrestricted portfolios — the Standard & Poor 500 and the Chicago Center for Research in Security Prices value-weighted market indexes. From May 1990 through December 1994, the average monthly returns of the DSI were 1.04 percent, statistically insignificant from the .90 percent for the S&P 500 and the .91 percent for the CRSP VW market index.

He also found that investors in socially responsible companies do not necessarily take greater risks than other investors. The DSI returns showed a 3.95 percent standard deviation rate in monthly returns, as compared to 3.59 for the S&P 500 and 3.57 percent for the CRSP VW market index. Total risk and market risk differences among the three were also statistically insignificant.

To look at screening and monitoring costs of applying social responsibility criteria, Sauer compared the performance of the Domini Social Equity mutual fund to the Vanguard Index 500 mutual fund and the Vanguard Extended Market mutual fund. When he looked at the net performance, the gross returns minus the costs, he found the screening and monitoring costs were a negligible part of the whole. "As a total package, the socially responsible fund wasn't penalized by the additional costs," Sauer said.

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For media interviews, contact **David Sauer** at (937) 229-2757 or via e-mail at sauer@quark.sba.udayton.edu. For a copy of Sauer's study, contact **Pam Huber** at (937) 229-3241 or via e-mail at huber@udayton.edu. The Social Investment Forum study can be found online at http://www.socialinvest.org/InvSRItrends.htm.